EXHIBIT 6

Ernst & Whinney

Review of Depreciation Policies and Procedures in Selected Industries

Prepared For:
The United States Telephone Association
December 9, 1986

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Preface

This study was supported by funds provided through the United States Telephone Association. It was conducted by the Telecommunications Group of Ernst & Whinney.

The Telecommunications Group is a specialized practice within Ernst & Whinney, one of the world's largest professional services firms. Founded in 1970, the Telecommunications Group includes over sixty professionals based in three offices: Tacoma, Washington; Walnut Creek, California; and Washington, D.C. Members of the practice spend their full time addressing the operational, regulatory, financial, accounting, and tax challenges facing the telecommunications industry. They provide marketing studies, economic and financial analyses of competitive and regulatory issues, and sophisticated accounting systems and techniques to a broad range of clients. Clients include small Independent telephone companies, large telephone companies (both Bell and Independent), domestic and international long-distance carriers, large telecommunications users, radio common carriers, industry associations, and government agencies throughout the United States and in other countries. Members of the professional staff have expertise in a wide variety of disciplines, including accounting, finance, statistics, marketing, and strategic planning.

This study draws on the expertise of our Telecommunications Group personnel, Ernst & Whinney industry experts, and executives who provide

professional services to the companies included in the study. It also relies on candid input from representatives of the companies included in the survey.

We would like to acknowledge the constructive input we received during the course of this project from the staff of the Federal Communications Commission, specifically, Ms. Robin Holmes, Mr. Kenneth Moran, and Mr. Richard Kirkman. We would like to thank Mr. Irvin Fries of Southwestern Bell Telephone Company, Mr. Thomas Costello and Ms. Judith Moen of Illinois Bell, and Mr. Robert Huhta of NYNEX Service Company for their support during this project.

EXECUTIVE SUMMARY

I. Overview

Ernst & Whinney's Telecommunications Group was engaged by the United States Telephone Association to compare procedures used to account for depreciation by telephone companies and by companies from a group of industries with similar characteristics. The results of that study, contained in this report, are based on research in published accounting literature and on extensive interviews with Ernst & Whinney personnel and company executives. Interviews provide information about practices currently followed in companies that face market conditions which may be similar to those faced by telephone companies now or in the future. Published accounting literature provides theoretical insight into depreciation accounting in enterprises, chiefly unregulated, that conform to generally accepted principles of financial reporting. The conclusions drawn from this theoretical and empirical research will assist telephone companies to develop depreciation policies that are consistent with those of unregulated firms.

II. Summary of Survey Results

Sixteen companies in the airline, cable TV, computer manufacturing and electric utility industries were surveyed to determine the factors which influence management decisions with respect to depreciation methods and procedures, depreciable lives, and the depreciation processes used to

establish these methods and lives. The overall objective of the survey is to determine what lessons may be learned from these industries that would have application to the telephone industry as it continues its transition to an increasingly competitive marketplace.

- Depreciation Methods and Procedures

Fourteen of the sixteen firms surveyed use only the straight line method of depreciation. Two of the computer manufacturing companies employ accelerated depreciation methods for most of their depreciable assets. In applying these methods, all of the unregulated companies use unit depreciation accounting and they reflect gains or losses on the disposal of assets in their income statements. The regulated electric utilities use group depreciation procedures similar to those employed by the telephone industry. Three of the computer manufacturing firms depreciate each asset individually. The airline companies perform similar unit depreciation calculations for investment in aircraft frames and engines. One of the computer manufacturers and all of the cable TV firms and electric utilities apply depreciation rates to categories of depreciable property.

The airline companies use the straight line method to maintain consistency both over time and with current industry practice. The cable TV companies also use the straight line method to be consistent with industry practice. The computer manufacturers utilize the double declining balance method because of the high rate of

technological obsolescence experienced by that industry. The electric utilities use straight line procedures due to regulatory requirements and because the industry has not experienced a high rate of obsolescence that would call for the use of accelerated depreciation methods. None of the companies state that tax depreciation plays a direct role in the selection of a particular depreciation method.

The majority of the unregulated companies maintain twenty-four or fewer depreciable categories of investment, while the electric utilities maintain approximately forty to fifty categories. The airline and computer manufacturing companies calculate depreciation on a unit by unit basis for most assets. Thus, depreciable categories are maintained for financial reporting purposes rather than for depreciation expense calculations.

None of the companies has changed depreciation methods in the recent past. Once a method of depreciation is selected as appropriate, companies generally continue to use that method.

Regarding the accounting for salvage and removal costs, the airline and electric utility industries recognize net salvage values in establishing depreciation rates. The airline companies estimate net salvage by relying on industry norms which, in some cases, are tempered by management judgment. Electric utilities periodically complete salvage and cost of removal studies similar to those

performed by the telephone industry. The computer manufacturers and cable TV firms ignore net salvage in developing depreciation rates due to the immaterial nature of these amounts.

The companies surveyed use a range of levels in determining whether to expense or capitalize the costs of assets of relatively small value. These dollar ranges are $250-$1,000, $400-$1,000, $250-$1,000, and $500 for the airline, computer manufacturing, cable TV, and electric utility industries, respectively. Companies determine these levels by reviewing historic data on the materiality of these items and the administrative costs associated with accounting for them. These levels apply to fixed assets with a useful life greater than one year. Exceptions to this rule include the construction of facilities by the cable TV and electric utility companies where the construction costs of facilities are capitalized. The appropriateness of these amounts are reviewed by the companies on an as needed basis with no predetermined frequency.

None of the companies uses different depreciation methods for different business segments or locations. The selection of a depreciation method appears to be influenced by the general nature of a company's business and the type of assets it employs.

- Depreciable Lives

The unregulated companies surveyed do not have complicated processes or procedures to estimate the lives of depreciable assets. They establish depreciable lives on the basis of management judgments regarding the future economic usefulness of assets. Their estimates rely on input from a variety of sources including engineering, operations, marketing, and planning personnel. The electric utilities maintain vintage year data and use actuarial or simulation techniques to estimate average service lives. In the majority of cases, the companies' controller or Chief Financial Officer approves depreciation methods and lives.

The unregulated companies cite technological obsolescence most frequently as the factor which influences depreciation lives. Other factors frequently identified include replacement policies of equipment, product life cycles, industry norms, conservatism, and the duration of franchises. Cable TV firms view franchise duration as the major factor influencing asset lives in their industry, since the duration of the franchise determines the future revenue stream produced by the assets. The computer manufacturers identify technological obsolescence as the most significant factor to consider when establishing depreciation lives.

The replacement policy for aircraft was considered the most important factor influencing depreciation lives by the airline industry.

The electric utilities did not identify any single factor as the most important cause of depreciation; they reflect all causes of depreciation in their actuarial studies.

- Depreciation Processes

All three nonregulated industries have informal processes for evaluating the reasonableness of depreciation lives. In electric utilities, on the other hand, depreciation departments perform depreciation studies and monitor theoretical reserve levels. The companies change depreciable lives with varying frequency, ranging from an as needed basis to every three to five years. An indication that the lives they use are reasonable is that the companies who monitor gains and losses on disposal of assets report only small gains or losses.

The unregulated companies expend very little effort evaluating depreciation methods, lives and salvage. They expend more effort for the purpose of determining monthly depreciation amounts than for evaluating depreciation practices. Various departments such as engineering, operations, and marketing provide informed input to help the accounting departments judge the reasonableness of depreciation lives. Generally, the companies surveyed here devote less than the equivalent of one person year per year at middle level management to evaluate depreciation.

In virtually all of the companies surveyed in all industries, depreciation rates and accruals have no effect on capital investment and modernization of the companies. Rather, economic considerations, franchise requirements (cable TV industry), product changes, and long term replacement policies determine levels of capitalization and modernization.

- Implications of Survey Results for the Telephone Industry

If exchange carriers adopted policies and procedures similar to those of the unregulated companies surveyed, we believe they would continue to use straight line group depreciation procedures for most assets. However, the telephone industry probably would maintain fewer categories, thus simplifying the depreciation process. Telephone companies also would use unit depreciation procedures and accelerated methods for assets subject to rapid obsolescence, such as switching equipment and computers.

We also believe that the service lives for some assets would be shortened; after this adjustment, however, the industry ranges would tend to fall within a pattern similar to that exhibited by the unregulated companies. Further, less emphasis would be placed on salvage and cost of removal estimates where the materiality of net salvage is insignificant.

Companies would strive for consistency in methods (straight line versus accelerated). Expensing levels also would be increased consistent with those of the unregulated companies. And, much less effort would be expended in estimating depreciable lives and monitoring the adequacy of depreciation reserves.

Further, much less reliance would be placed on historic data and more emphasis would be given to the future economic usefulness of assets. Finally, depreciation policies would continue to be constrained by the requirements of generally accepted accounting principles that depreciation be rational, reasonable, and consistent.

III. Depreciation Expense As It Relates to GAAP

- Generally Accepted Accounting Principles

Depreciation expense is a method of accounting for capital recovery in the income statement of a business enterprise. The fundamental purpose of the modern corporate income statement is to inform outsiders about a profit-making enterprise's ability to generate favorable cash flows. The test of an enterprise's operating prowess is the extent to which cash returned to owners exceeds the cash invested by owners over the long run. A successful enterprise manages to generate both a return **of** its invested capital and a satisfactory return **on** its invested capital.

Measuring an enterprise's financial performance is complicated by the fact that cash actually flowing in and out of the enterprise during a short period such as a year bears no necessary relation to the enterprise's ability to generate favorable cash flows over the long run. Cash flows, in the short run, for a variety of reasons--purchase assets, pay dividends, repay debt, sell obsolete inventory--that have no bearing on the enterprise's ability to generate a sustained increase of cash in the long run. Consequently, accountants developed accrual accounting procedures to identify cash-using or cash-generating operating events in the period that an event occurs, not in the period when the cash flows. These accrual procedures are the foundation upon which modern income reporting, and depreciation accounting in particular, is based.

- Generally Accepted Principles of Depreciation Accounting

At the heart of accrual accounting is depreciation expense, the periodic recognition that part of an enterprise's operating cash inflows represents the recovery (return) of capital (cash) invested previously in long-lived cash generating assets. By providing information about the return of an enterprise's capital, depreciation expense presumably helps outsiders evaluate the return on capital that is implicit in an enterprise's cash flows.

Depreciation expense is reported in financial statements according to generally accepted accounting principles (GAAP), the authoritative

standards that accountants follow to prepare audited financial reports of companies. Generally accepted principles of depreciation accounting require that the original acquisition cost of an asset must be allocated (i.e., deducted from income) systematically and rationally over the asset's estimated useful life. Specific procedures for depreciation accounting entail identifying the amount of an asset's depreciable base, estimating an asset's useful life, and selecting a systematic and rational method to allocate the amount of an asset's base over its life. These procedures, accountants are careful to point out, comprise a process of allocating, not valuing, an asset's cost.

The question of what constitutes a long-lived asset's value is a thorny one that accountants usually separate from questions of depreciation policy. Accountants associate depreciation expense with the periodic allocation of cost. Whether the cost being depreciated should correspond to an asset's current market worth is a separate issue. GAAP always has taken issue with writing up the depreciable base of assets. Recently, however, accountants have given increased attention to the issue of accounting for long-lived assets that decline in value. This issue has arisen lately in many industries where technological change and/or deregulation have unexpectedly reduced the utility of long-lived assets that are still in use.

An unregulated company can account for a potential impairment of asset values in one of three ways. These three choices are ignoring asset write-downs altogether, writing asset values down partially, or shortening the remaining depreciable lives of assets. There is little question that one writes off the book value of an asset that is not in service and thus has no economic value. Questions surround the accounting treatment of assets that are still in use but are not anticipated to contribute to revenue streams to the extent originally planned. GAAP does not offer explicit guidance in this area, although we suggest that existing GAAP favors shortening the depreciable lives of impaired operating assets rather than partially writing down their book value. Some accountants, however, favor writing down the value of "impaired" depreciable assets, a policy that corresponds to the treatment of marketable assets or saleable inventories that have fallen in value. The AICPA has urged the FASB to study this issue and the FASB has discussed putting the matter on its agenda.

GAAP acknowledges that the principles which govern the recovery of capital invested in long-lived assets may differ between regulated and unregulated enterprises. These differences presume that a regulated enterprise's prices are set to recover costs, while an unregulated enterprise faces the uncertain prospect of recovering costs from prices that are set in the marketplace. Where the prices charged by an enterprise meet the criterion of recovery through regulated rates, then GAAP allows the enterprise to report certain

economic events differently than would an unregulated enterprise. In particular, the regulated enterprise may capitalize virtually any past or present costs for which recovery through regulated rates will be permitted. However, a regulated enterprise must revert to following unregulated GAAP at any time that its prices do not meet the recovery criterion. This applies, in the case of telecommunications companies, to parts of an enterprise's activities that may be deregulated.

The FASB is presently considering an amendment to the statement that provides financial reporting rules for regulated enterprises. The amendment covers accounting for the unrecovered costs of plant that regulators have deferred or disallowed and for the cost of plant that has been abandoned. The general thrust of the amendment is to limit sharply the circumstances in which a regulated enterprise may continue to capitalize deferred, disallowed, and abandoned plant costs.

Present proposals to amend GAAP will narrow the existing minor differences in accounting for the recovery of capital between regulated and unregulated enterprises. Differences in capitalization and depreciation policies may remain. But these exceptions must be justified increasingly by clear evidence that regulated prices will enable costs to be recovered.

- Contrasts Between GAAP and Regulated Industry Accounting for Depreciation

There are some significant differences in the importance of and approach to depreciation issues under economic regulation versus GAAP, as employed by unregulated industries. First, the allowed levels of depreciation directly impact the financial well being of regulated firms through the ratemaking process. This is not the case for unregulated companies. Second, more stringent standards apply to the determination of telephone industry depreciation rates. Depreciation rates in the telephone industry, although initially proposed by management, are generally subject to extensive regulatory review. The preparation of the complex actuarial studies required imposes a burden on telephone companies that is not imposed on unregulated firms. This burden is imposed to ensure that depreciation rates meet the public interest standard of the Communications Act. But the review process imparts to depreciation calculations an unattainable semblance of precision. GAAP, perhaps recognizing the uncertainty in estimating future depreciable lives, imposes less stringent standards of review. Thus, for the unregulated firm, the determination of depreciation rates is principally a matter of management judgment, subject to the constraint that depreciation be recognized in a systematic and rational manner.

Telephone companies will operate in increasingly competitive markets in the future. It is apparent already that competition will diminish

the probable future benefit of assets, such as analog electronic switches, that incorporate older technologies. As competition and the marketplace increasingly determine prices, there will be less certainty for any company that those prices will be sufficient to provide both a return on and return of invested capital. In this environment, the depreciation practices used by telephone companies will have significantly less impact on their financial performance. Consequently, the level of oversight required will diminish considerably and traditional regulatory considerations related to the economic effects of depreciation will lose their relevance.

IV. Depreciable Lives Under the Internal Revenue Code

Since depreciation was first allowed as a tax deduction in 1913, a variety of methods and approaches to life determination have been used by the Internal Revenue Service (IRS). From 1931 through 1962, the IRS relied on "Bulletin F" (published in 1931, updated in 1942) lives, generally based on industry experience and surveys, as guidelines for evaluating claimed tax depre- ciation. Accelerated depreciation was first permitted under the Internal Revenue Code of 1939, although limited to one and one-half times straight line. More liberal accelerated methods were allowed under the major revision to the Internal Revenue Code enacted in 1954 in order to stimulate the economy.

In 1962, the IRS withdrew Bulletin F and replaced it with Revenue Procedure 62-21 which employed Guideline Lives for asset groups. After

enactment of the Revenue Act of 1971, Guideline Lives were replaced by the Asset Depreciation Range (ADR) system. ADR midpoint lives were initially based on the Guideline Lives. Studies were done by the IRS Office of Industrial Economics during the 1970's which led to modifications of the Guideline Lives, notably in 1977. These studies typically relied on the relatively easy to apply turnover method of life analysis.

The Economic Recovery Tax Act of 1981 introduced the Accelerated Cost Recovery System (ACRS) for assets placed in service after 1980. ACRS lives were typically much shorter than ADR and economically "useful" lives. Assets were grouped into four broad categories to be depreciated over 3, 5, 10 or 15 years, using an approximation of the double declining balance method.

Passage of The Tax Reform Act of 1986 resulted in a general lengthening of tax lives compared to ACRS. However, as with ACRS, the lives permitted are not intended to reflect economically "useful" lives.

Depreciable lives and depreciation methods for tax purposes have been frequently altered over the years in order to respond to, and affect, general economic conditions. Historically, tax lives have not been used for financial reporting because they were considerably shorter than the economically useful lives determined by company management and required under GAAP.

V. Analysis of Selected Financial Data

Selected financial data was reviewed to determine if firms adjust depreciation expense upward or downward depending on the levels of property acquisitions over time. In addition, pertinent data was reviewed to determine the relationship of depreciation expense to total revenue and total expenses to see if variances exist which might provide insight into management's actions when revenues and total expenses vary over time.

The following financial ratios were deemed most pertinent to these objectives:

1) Depreciation expense as a percent of gross additions.
2) Depreciation expense as a percent of average gross property.
3) Depreciation expense as a percent of total revenues.
4) Depreciation expense as a percent of total expenses.

Based on this analysis it appears that:

- Companies do not arbitrarily adjust depreciation expense up or down as gross additions vary from year to year.
- The percent of depreciation expense to average gross property remains relatively constant over time.
- Depreciation expense as a percent of revenue is generally less for unregulated firms than for telephone companies. The relatively higher ratio of depreciation expense is in part a function of the capital intensive nature of this industry. This characteristic also affects the ratio of depreciation expense to total operating expense in these industries.

The results of our examination of selected depreciation related financial ratios are consistent with the survey results. Because depreciation expense is primarily viewed as a financial reporting matter by unregulated firms, the principal emphasis in determining depreciation

rates is to fully and accurately reflect the firm's financial condition over time. As such, depreciation accruals have little or no relationship to capital investment policies which are based on forces external to the financial reporting process.

CERTIFICATE OF SERVICE

I, Magdalene Copp, a secretary of the law office of Ross & Hardies, do hereby certify that I have this 25th day of August, 1993, served by first-class mail, postage pre-paid, a copy of the foregoing "Comments of the Medium-Sized Operators Group" to:

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